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## BEFORE THE ARIZONA CORPORATION

**COMMISSIONERS**

BOB STUMP, CHAIRMAN  
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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF  
CHAPARRAL CITY WATER COMPANY FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR INCREASE IN ITS RATES  
AND CHARGES BASED THEREON.

DOCKET NO. W-02113A-13-0118

STAFF'S REPLY BRIEF

ORIGINAL

**I. INTRODUCTION.**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission" or "ACC") hereby files its Reply Brief in the above captioned matter. Staff maintains its position as presented in its Opening Brief and in its testimony on any issue not specifically addressed here. Staff will address several issues raised by Chaparral City Water Company ("CCWC" or "Company"), the Residential Consumer Utility Office ("RUCO"), and the Water Utility Association of Arizona ("WUAA").

**II. HYPOTHETICAL CAPITAL STRUCTURE.**

In its Brief, the Company claims that a hypothetical capital structure ("HCS") is a "newfound approach" and was "done without detailed analysis,"<sup>1</sup> an anomaly, used against CCWC solely to reduce its rates. This is incorrect. The Commission has imputed a HCS in situations where an imbalance in the capital structure has the potential to either impermissibly burden rate payers or hamper the operation of a company. The imbalance in capital structure can be a result of either too much debt or too much equity.

Mr. Patterson, on behalf of WUAA, argues that Staff is proposing a policy change, or attempting to hide a policy change, by characterizing it as an adjustment.<sup>2</sup> However, the use of a

<sup>1</sup> CCWC Opening Brief at 3.

<sup>2</sup> WUAA Closing Brief at 2-3.

1 HCS is neither new nor a policy change. Staff is not suggesting that under certain specified  
2 circumstances a HCS should always be adopted. A HCS recommendation is made on a case by case  
3 basis. Simply because a Company is equity rich may not always result in a recommendation of a  
4 HCS. Staff has both supported and opposed HCS's in the past. The Company identified several  
5 cases where Staff had not recommended a HCS despite the presence of equity rich companies.<sup>3</sup> In  
6 those cases Staff employed a different methodology. For example, in the Rio Rico case, Staff  
7 recommended a financial risk adjustment to the return on equity ("ROE") to compensate for the  
8 imbalanced capital structure.<sup>4</sup> Staff chooses the best option to fit each application on a case by case  
9 basis.

10 In Southwest Gas Corporation's 2004 rate case, Staff, RUCO and Southwest Gas all proposed  
11 a hypothetical capital structure.<sup>5</sup> Southwest Gas' actual capital structure was 34.5% equity, 5.3%  
12 preferred stock and 60.2% debt. Southwest Gas' equity position had been low for a decade.<sup>6</sup> The  
13 Commission adopted a hypothetical capital structure of 40% equity, 5% preferred stock and 55%  
14 debt.<sup>7</sup> The Commission believed that the Company needed to continue to aggressively reduce its  
15 debt to match the HCS because the Commissioners were concerned about the "continuing need to  
16 employ an inflated equity ratio for setting rates in case after case."<sup>8</sup> The Commission also indicated  
17 it would only be willing to allow the ratepayers to be burdened by an unbalanced capital structure to a  
18 certain extent before taking action.<sup>9</sup>

19 In Tucson Electric Power Company's ("TEP") 1993 rate case, the Commission used a HCS  
20 for TEP to set rates.<sup>10</sup> Through a series of missteps, TEP came to a point in the late 1980s where it  
21 could not pay its bills, and was the subject of an involuntary petition for bankruptcy. TEP reached an  
22 agreement for restructuring with its shareholders and creditors which resulted in the dismissal of the  
23 involuntary bankruptcy petition. As a consequence, TEP was left with heavily diluted stock, deferred

24 <sup>3</sup> Tr. at 400 – 412; Decision No. 74294 at 46; Decision No. 73996 at 7.

25 <sup>4</sup> Decision No. 73996.

26 <sup>5</sup> Docket No. G-01551A-04-0876; Decision No. 68487.

27 <sup>6</sup> Decision No. 68487 at 24.

28 <sup>7</sup> *Id.* at 23-25.

<sup>8</sup> *Id.* at 25.

<sup>9</sup> *Id.*

<sup>10</sup> Docket No. U-1933-93-006; Decision No. 58497.

1 expenses and a capital structure that consisted entirely of debt; the Commission adopted a  
2 hypothetical capital structure of 51.23% debt and 48.77% equity. The Commission added equity in its  
3 adoption of a hypothetical capital structure because TEP's capital structure was 100% debt. In  
4 Decision No. 59594, the Commission adopted a different HCS for TEP. There the Commission  
5 adopted a HCS of 37.5% equity and 62.5% debt, recognizing an improvement in TEP's financial  
6 health.<sup>11</sup>

7 Another example of HCS occurs in Global Water Decision No. 71878. In that case, Global  
8 Water had several systems where the capital structure was equity heavy.<sup>12</sup> The Willow Valley  
9 system had an 18.7 percent debt and 83.3 percent equity ratio, a very similar structure to that of  
10 CCWC. All six systems in Decision No. 71878 were equity heavy and all parties proposed  
11 hypothetical capital structures, which the Commission adopted. Staff's stated reason for  
12 recommending the adoption of a HCS was because it was "necessary to protect Willow Valley and  
13 Valencia-Town ratepayers from inefficient capital structures."<sup>13</sup>

14 Other state commissions have recognized that using the actual capital structure of a utility for  
15 rate making purposes may be burdensome on the ratepayer and determined that a HCS is warranted.  
16 *Citizens Utilities Co. v. Idaho Public Utility Commission* (1987),<sup>14</sup> states that while ratepayers benefit  
17 from financially sound utilities, a commission is not bound to use the actual capital structure and can  
18 use a HCS in its place. The imputation of debt to protect ratepayers from burdensome rates was  
19 found to be proper.<sup>15</sup> *Zia Natural Gas Co. v. New Mexico Public Utility Commission* (2000),<sup>16</sup> states  
20 the actual capital structure is a management decision for the utility, but the Commission can set rates  
21 based on the optimum capital structure. It further finds that if the Commission were forced to use the  
22 utility's chosen structure it would over-inflate the interest of shareholders and burden the  
23 ratepayers.<sup>17</sup> *State ex. Rel., Missouri Gas Energy v. Pub. Serv. Comm'n* (2005), states that a  
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25 <sup>11</sup> Docket No. U-1933-95-0317; Decision No. 59594.

26 <sup>12</sup> Docket Nos., SW-20445A-09-0077 et. al.

27 <sup>13</sup> Decision No. 71878 at 26 – 27.

28 <sup>14</sup> 112 Idaho 1061, 739 P.2d 360.

<sup>15</sup> *Id.*

<sup>16</sup> 128 N.M. 728, 998 P.2d 564.

<sup>17</sup> *Id.*

1 commission must balance its decision between the consumers and the shareholders and that selecting  
2 a HCS that balances an otherwise equity rich structure is proper.<sup>18</sup>

3 In this case, CCWC is a subsidiary of a much larger holding company, where all the other  
4 affiliates have more balanced capital structures, and are more aligned with what Staff typically deems  
5 appropriate. CCWC's capital structure is skewed heavily toward equity which results in an  
6 unreasonable increase in cost to the rate payers. A capital structure with a disproportionately high  
7 amount of equity will cause higher rates being charged to customers, where a more balanced  
8 approach will result in the same level of service for a lower rate.<sup>19</sup>

9 As in the *Citizens v. Idaho* case above, the ACC is not bound to use a company's actual  
10 capital structure and may use a HCS in its place. Such a finding does not require the Company to  
11 change its capital structure. However, pursuant to the Commission's ratemaking authority, it will  
12 treat CCWC as if its capital structure is 60 percent equity and 40 percent debt. In this way, the  
13 Company will be more aligned with the proxy companies and the benefits and burdens of the equity  
14 ratio will be equalized between the Company and the rate payers, who have no control over what that  
15 ratio is.

16 The topic of double leveraging was also an issue at hearing.<sup>20</sup> While double leveraging is  
17 relevant, Staff agrees with RUCO in that it is not a pre-requisite for the Commission to adopt a  
18 HCS.<sup>21</sup> Double leveraging was not discussed in any other decision where the Commission has  
19 adopted a HCS. Furthermore, as Ms. Ahern, Mr. Parcell, and Mr. Cassidy indicated, it is very  
20 difficult to prove that double leveraging exists.<sup>22</sup> However, the potential for double leveraging further  
21 supports the adoption of a HCS.

22 Another component of CCWC's proposed capital structure is higher income tax expense due  
23 to lower weighted average cost of debt.<sup>23</sup> This results in lower synchronized interest expense and  
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26 <sup>18</sup> 186 S.W.3d 376 (Mo.Ct.App. 2005).

<sup>19</sup> Cassidy Dir. Test., Ex. A-14 at 10.

<sup>20</sup> Tr. Vol. II at 406-418.

<sup>21</sup> RUCO Closing Brief at 22.

<sup>22</sup> Tr. Vol. II at 206 – 209, 285 – 286, 288, 379 – 380.

<sup>23</sup> Tr. Vol. V at 878, 916-918.

1 higher taxes.<sup>24</sup> Meanwhile, the parent company enjoys the benefit of tax savings associated with  
2 higher interest expense deductions. While the parent allocates costs that harm the ratepayer,<sup>25</sup>  
3 CCWC does not want to share the effective allocation of interest expense which would help the  
4 ratepayer. This further compounds the unfair and unbalanced nature of the Company's current  
5 proposed capital structure.

### 6 **III. DEPRECIATION EXPENSE.**

7 The Company's comparison of the vintage group method described in NARUC's guidelines  
8 and the vintage year method utilized by Staff is irrelevant to this case. Staff did not base its  
9 methodology on that described by NARUC. Even the Company so conceded when it notes that Staff  
10 had not seen or reviewed the NARUC Guidelines in making its recommendations.<sup>26</sup> Staff created its  
11 vintage year methodology independently several years ago.

12 CCWC proposes that, as an alternative to adopting the vintage year method, the Commission  
13 should adjust the depreciation rates for the two accounts in which Staff identified over-depreciation.  
14 This method reduces the amount of depreciation. However, this change was not calculated until after  
15 the conclusion of the hearing in CCWC's post-hearing final schedules.<sup>27</sup> Even as late as the final day  
16 of hearing, Company witness Sheryl Hubbard, when asked if the Company was requesting the  
17 Commission to authorize the depreciation rates adopted in the prior case, indicated that CCWC had  
18 not recommended a change in those rates.<sup>28</sup> At the commencement of the hearing, held some 10  
19 months after the application was docketed, the Company continued to support its existing  
20 depreciation rates and, on that basis, stated its accumulated depreciation and depreciation expense at  
21 \$25,773,188 and \$2,015,540, respectively.<sup>29</sup> The Company's post hearing adjustments to depreciation  
22 rates resulted in accumulated depreciation and depreciation expense of \$25,320,747<sup>30</sup> and  
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25 <sup>24</sup> *Id.*

26 <sup>25</sup> CCWC Final Schedule C-1 at 1 Line 12-13 Intercompany Support Services & Corporate Allocations.

27 <sup>26</sup> Tr. Vol. V at 930, 954.

28 <sup>27</sup> CCWC Final Schedule C-2 at 2.

29 <sup>28</sup> Tr. Vol. V at 807.

30 <sup>29</sup> Ex. A-6 Attachment SLH-1R at 2-3.

<sup>30</sup> CCWC Schedule B-2 Final.

1 \$1,688,127,<sup>31</sup> respectively, reflecting differences from Staff's final position of only \$452,441 and  
2 \$327,413, respectively.

3 Had this eleventh hour shift in position occurred earlier in the case, allowing Staff to consider  
4 that alternative and to address it with the Company, this case may have been in a much different  
5 status. That did not happen and the Company continued to argue its higher amounts. Moreover, Ms.  
6 Hubbard acknowledged that the Company's proposed changes in rates were made without any  
7 depreciation studies or any evidence to support its proposed new rates.<sup>32</sup> The last minute change in  
8 rates give rise to concerns that the Company's proposal for depreciation changes, as a means of  
9 addressing the risk of over-depreciation, was not well-thought out. This is apparent given that this  
10 specific change in depreciation rates was first provided by the Company during the Administrative  
11 Law Judge's questioning of Ms. Hubbard.<sup>33</sup> None of the parties had an opportunity to analyze such  
12 an alternative or present any testimony or other evidence of its viability. Further, as Staff stated in its  
13 Opening Brief, this alternative would reduce the risk of over-depreciation but not to the degree that  
14 Staff's proposal would.

15 Mr. Patterson, on behalf of WUAA, asserts that what Staff is proposing here is also a new  
16 policy which should be addressed, not in an individual company's rate case, but in a series of  
17 workshops, white papers or other public processes.<sup>34</sup> Staff's proposed vintage year methodology is  
18 neither new nor a policy. Staff has previously proposed, and the Commission has previously adopted  
19 a vintage group method. In its Opening Brief, Staff discussed several cases in which this vintage year  
20 method was considered, and the New River Utility Company rate case in which it was adopted.<sup>35</sup>  
21 These include the 2009 Bella Vista family of cases, the 2012 Rio Rico case and the 2012 New River  
22 case decided in 2014.<sup>36</sup> Further while Mr. Patterson expresses concern over the cost of implementing  
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25 <sup>31</sup> CCWC Schedule C-2 Final.

26 <sup>32</sup> Tr. Vol. V at 807-808.

27 <sup>33</sup> Tr. Vol. V at 852-854.

28 <sup>34</sup> WUAA Closing Brief at 1.

<sup>35</sup> Staff's Opening Brief at 11; Bella Vista Water, Decision No. 72251; Rio Rico Utilities, Decision No. 73996; New River Util. Company, Decision No. 74294.

<sup>36</sup> *Id.*

1 Staff's vintage method he does not address the potential cost to conduct or produce workshops or  
2 white papers.

3 The methodology has been under consideration for at least four years which refutes  
4 allegations that it is not well thought out, or that as WUAA avers, it was "invented" based on one  
5 day's work on an Excel spreadsheet.<sup>37</sup> In fact, Staff would note that WUAA misstates Mr. Becker's  
6 testimony when it so asserts. Mr. Becker acknowledged that it took him a day to make the conversion  
7 of depreciation amounts from the group to the vintage method, not to create the vintage method.<sup>38</sup>

8 WUAA also argues that Staff's vintage year method tilts the regulatory balance accelerating  
9 the removal of items to prevent over-depreciation while not increasing the pace at which investments  
10 are added to rate base.<sup>39</sup> There are many complex elements to a rate case which are related to  
11 regulatory lag and impact ratepayers and utilities both negatively and positively, including the  
12 System Improvement Benefit ("SIB"), which Staff recommends here. Staff's recommendations in  
13 this case attempt to balance all of those elements in a manner most fair to the Company and its  
14 ratepayers. Moreover, the issue here is not just about regulatory lag; it is about the Company  
15 recovering significantly more than it invested. WUAA fails to address how this over collection would  
16 be mitigated or addressed in this case.

17 WUAA asserts that depreciation expense is not over-collected because, when depreciation  
18 continues to accrue beyond the expected life of the plant in question, the accumulated depreciation  
19 account associated with that asset will have a negative balance equal to the amount of over-  
20 depreciation. When the replacement plant is placed in service, its book value will be the purchase  
21 price of the new asset less the negative accumulated depreciation associated with the retired plant.<sup>40</sup>  
22 This argument is flawed in more than one respect. The over-depreciation results in a higher  
23 accumulated depreciation account balance, which acts to reduce rate base, but it does not change the  
24 valuation of the replacement asset included in utility plant in service ("UPIS"). However, a reduction  
25 in rate base does not provide a dollar for dollar benefit. The ratepayer benefits only by the amount of

26 <sup>37</sup> WUAA's Closing Brief at 7.

27 <sup>38</sup> Tr. Vol. V at 876, 903.

28 <sup>39</sup> WUAA Closing Brief at 5.

<sup>40</sup> WUAA Closing Brief at 6-7.

1 the rate of return applied to the amount by which the rate base is reduced, at a rate of approximately  
2 eleven cents per dollar.<sup>41</sup> In contrast, the annual depreciation expense, which flows to the benefit of  
3 the Company, is a dollar for dollar recovery.<sup>42</sup>

4 In addition, when the replacement plant is placed in service, its *book* value may reflect the  
5 purchase price less the negative depreciation balance, but its UPIS balance does not. The UPIS  
6 balance is the value on which depreciation is calculated, and the UPIS balance is the purchase price  
7 with no adjustment for the negative accumulated depreciation account balance. Thus, the Company  
8 will not lose any recovery via depreciation expense as a result of the higher accumulated depreciation  
9 account balances.<sup>43</sup>

10 Regarding the alleged complexity of tracking vintage year in the future, Mr. Patterson argues  
11 that IRS accounting differs from vintage year accounting, suggesting that data maintained for the IRS  
12 will not be helpful. However, he does not cite to those specific differences. WUAA also asserts that  
13 the vintage year method is complex and unwieldy.<sup>44</sup> Yet no evidence has been presented to support  
14 that. In fact, Staff's method is simple. The Company must merely maintain records of when plant is  
15 added on an annual basis, when the plant reaches the end of its expected life, and when the plant is  
16 fully depreciated, the collection of depreciation must cease.<sup>45</sup> Ironically, WUAA also refers to the  
17 Company's system as complex.<sup>46</sup>

#### 18 **IV. USED AND USEFUL POST-TEST YEAR PLANT.**

19 RUCO suggests that because Staff did not conduct a second site visit after post-test year plant  
20 was added, it did not perform its due diligence. As Ms. Stukov testified, most of that plant was  
21 underground and could not be examined, or consisted of items that are "irrelevant" to inspect.<sup>47</sup> For  
22 the remaining post-test year items, she utilized the Company's testimony and data request responses.  
23 Staff believes it is completely reasonable for Ms. Stukov to make this determination. She had  
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25 <sup>41</sup> Tr. Vol. V at 820-822.

26 <sup>42</sup> *Id.*

27 <sup>43</sup> Staff Final Schedule GWB-16.

28 <sup>44</sup> WUAA Closing Brief at 7.

<sup>45</sup> Becker Amended Sur. Test., Ex. S-11 at 13.

<sup>46</sup> WUAA Closing Brief at 7.

<sup>47</sup> Tr. Vol. III at 573; RUCO Closing Brief at 4.



1 previously visited and had a working knowledge of the CCWC system.<sup>48</sup> Her prior examination  
2 indicated that the Company had reported plant accurately and fully. When utilizing that gathered  
3 knowledge and comparing it to the additions listed by the Company, she could use her expertise to  
4 determine if an additional inspection would be fruitful and if the items listed would be considered  
5 "used and useful" additions. RUCO in its brief acknowledges that it generally relies on Staff's  
6 engineer for a used and useful determination.<sup>49</sup> If RUCO had a problem with Staff's assessment, then  
7 it certainly could have hired its own engineer to make that determination instead of implying that Ms.  
8 Stukov is not able to determine what is and is not used and useful plant.

9 **V. RUCO HAS NOT PROVIDED A VALID JUSTIFICATION FOR REJECTING THE**  
10 **SIB IN THIS CASE.**

11 **A. The Company Should Be Awarded A SIB Under The Facts Of This Case.**

12 RUCO believes the Company should not be awarded a SIB.<sup>50</sup> Staff believes there was  
13 sufficient evidence provided to support the adoption of the SIB. CCWC demonstrated its need for the  
14 SIB through testimony and extensive engineering reports. Staff supported this through its own  
15 testimony and review of the Company's engineering reports. There are numerous exhibits in  
16 evidence in this case which demonstrate the requirements of the SIB and outline the need for the  
17 Company to have the mechanism available to them.<sup>51</sup>

18 RUCO points out that the Plan of Administration ("POA") for the SIB was filed by Staff and  
19 not the Company.<sup>52</sup> Staff is uncertain as to the significance RUCO places of this fact. The POA was  
20 provided as an example of what Staff expects in the POA. The Company would be expected to  
21 provide its version upon the granting of a SIB.

22 Staff would also note that the POA attached to Ms. Stukov's testimony was not intended as  
23 the final version of any POA in this case; the POA is a work in progress and still evolving as  
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26 <sup>48</sup> Tr. Vol. III at 572-573; Stukov Dir. Test., Ex. S-6 at 2; S-6 Attachment KS.

27 <sup>49</sup> RUCO Closing Brief at 4.

28 <sup>50</sup> *Id.* at 25.

<sup>51</sup> Ex. A-17, A-21; A-22; A-23; A-24; S-6.

<sup>52</sup> RUCO Closing Brief at 26.

1 experience with SIBs grows. A finalized version of the POA will be submitted by the Company  
2 within 30 days of the decision, a fact RUCO's own witness acknowledged in the hearing.<sup>53</sup>

3 RUCO did not have an engineering witness and presented no evidence to refute the  
4 engineering reports provided by the Company. From Staff's perspective RUCO has not supported its  
5 argument that the Company has not shown a need for the infrastructure replacement since RUCO has  
6 presented no controverting evidence through its own engineering witness. In fact, as far as Staff is  
7 aware, RUCO has made no independent analysis of the engineering information provided by the  
8 Company.

9 **B. The SIB Does Not Shift The Risk To The Ratepayer Without Adequate Financial**  
10 **Consideration.**

11 RUCO incorrectly asserts that the SIB is one-sided and only works in the interest of the  
12 Company and its shareholders.<sup>54</sup> This is simply not true. The SIB includes an efficiency credit that  
13 reduces the rate of return on the SIB related plant by five percent compared to the amount that  
14 customers would otherwise pay for this plant if the Company simply sought to recover such costs in  
15 its next rate case.<sup>55</sup> RUCO's primary assertion is that the efficiency credit is insignificant compared  
16 to the amount the Company will ultimately collect through the SIB surcharge, but inexplicably does  
17 not propose an alternative option.<sup>56</sup> It is also notable that SIB promotes rate gradualism and helps  
18 assure a reliable water service.

19 As part of its argument, RUCO seems to assert that a reason for not adopting a SIB is that the  
20 Company will have no incentive to control its costs with this type of mechanism in place. However,  
21 this argument nonsensically assumes two things: first, that the Company would be willing to  
22 haphazardly increase its expenses in lieu of earning its authorized rate of return and second, that  
23 Staff, RUCO and ultimately the Commission would fail to address this issue each time the Company  
24 seeks to implement a SIB surcharge, and ultimately in the follow up rate case required with the SIB.  
25 In fact, under the SIB, the Company must not only seek pre-approval of its proposed projects and the

26 <sup>53</sup> Tr. Vol. IV at 705.

27 <sup>54</sup> RUCO Closing Brief at 28 - 30.

<sup>55</sup> Stukov Dir. Test., Ex. S-6 Attachment C at 3.

28 <sup>56</sup> Tr. Vol. IV at 602 - 603.

1 estimate costs during the rate case, but it will be limited to recovery of no more than 110 percent of  
2 the estimated unit costs of those projects.<sup>57</sup>

3 **C. The SIB Is An Adjustor Mechanism.**

4 Although the SIB possesses characteristics not found in a traditional adjustor mechanism, it is,  
5 nonetheless, an adjustor mechanism. The SIB provides a mechanism to recover capital costs which  
6 can be estimated during the rate case but which will change after the rate case has concluded. The  
7 Commission has at times created novel and innovative adjustor mechanisms. There are many such  
8 mechanisms currently in use by the Commission, such as the renewable energy surcharge, energy  
9 efficiency surcharge, energy efficiency demand-side management surcharge, environmental  
10 improvement surcharge, and the Arsenic Cost Recovery Mechanism ("ACRM"). RUCO has  
11 acknowledged in previous decisions that an ACRM, which addresses a capital cost (not an expense)  
12 that will be determined following the rate case, is an adjustor mechanism.<sup>58</sup> Additionally RUCO has  
13 supported the ACRM in numerous cases.

14 Even if the SIB were deemed not to be an adjustor mechanism, such a determination would  
15 not cause the SIB to be illegal or unconstitutional. In the creation of the SIB, numerous protections  
16 were included to assure compliance with Constitutional requirements. The SIB proposed in the  
17 agreement has been developed in the context of a full rate case in which the Commission has  
18 determined the Company's fair value rate base ("FVRB"). The SIB will be limited to projects that  
19 replace plant used to serve existing customers. The SIB further provides for the retirement (removal  
20 from rate base) of the plant that has been replaced. Therefore, the new plant will not generate a new  
21 revenue stream.

22 RUCO repeatedly indicates in its brief that there is no meaningful fair value determination.<sup>59</sup>  
23 This is incorrect. The SIB requires the Company to provide fair value information at the time that it  
24 seeks Commission authorization to enact a SIB surcharge. This information will enable the  
25 Commission to update the FVRB finding and to determine the impact of the revenues (with the  
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27 <sup>57</sup> Stukov Dir. Test., Ex. S-6 Attachment C at 3.

28 <sup>58</sup> Arizona Water Co., Eastern Group, Docket No. W-01445A-11-0310, Tr. Vol. I at 24-25.

<sup>59</sup> RUCO Closing Brief at 34-36.

1 addition of the proposed SIB surcharge) on the Company's fair value rate of return. The SIB  
2 surcharge cannot go into effect without a Commission order, and the agreement further provides that  
3 the Commission may terminate the SIB at any time.

4 Mr. Michlik was asked what things he looks for when coming up with RUCO's recommended  
5 fair value determination. His response was that he looks at: a company's plant, invoices, components  
6 of the rate base, Advancements In Aid of Construction ("AIAC"), Contributions In Aid of  
7 Construction ("CIAC"), operating expenses, and depreciation rates.<sup>60</sup> Mr. Michlik was then walked  
8 through portions of the POA to confirm that everything done in a rate case to determine fair value is  
9 performed when a SIB surcharge is submitted.<sup>61</sup> The only item RUCO took issue with at hearing was  
10 the earnings test, stating that there is no examination of the expense items only the plant items.<sup>62</sup>  
11 However this is an incorrect assumption of how the earnings test works. The earnings test does take  
12 into account current expense levels. The purpose of the earnings test is to determine whether all or  
13 part of the surcharge requested by the Company should be authorized to go into effect. Should extra  
14 time be required to perform any part of a SIB filing review then Staff or RUCO may request an  
15 extension.

16 **D. The SIB Depreciation Expense Set Aside Is Not Justified.**

17 RUCO's position that the SIB should somehow require the Company to set aside depreciation  
18 expenses is not persuasive.<sup>63</sup> There is no indication in this case that the current ownership of CCWC  
19 has not made maintaining the system a priority. The Company has stated that since it took over  
20 CCWC in 2011 it has consistently spent money to repair and improve the system.<sup>64</sup> A set aside is  
21 unnecessary for a company that is committed to making improvements. No evidence has been  
22 presented in this case to suggest a set aside is appropriate or that it should be applied here.  
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26 <sup>60</sup> Tr. Vol. IV at 698.

27 <sup>61</sup> *Id.* at 698 – 704.

28 <sup>62</sup> *Id.* at 702.

<sup>63</sup> RUCO Closing Brief at 36-37.

<sup>64</sup> Tr. Vol. III at 496 – 501.

### E. The SIB Is Not A “Rubber Stamp.”

RUCO falsely asserts that the SIB mechanism is a rubber stamp process.<sup>65</sup> As has been shown in pre-filed testimony, extensive engineering reports, the briefs, and in several other cases where the Commission has approved a SIB, it is an extensive process. Additionally the Commission must review and approve each request when it is made and may choose to deny the request or even cancel the SIB at any time. This is just another attempt by RUCO to cloud the issue and try to show that the rigorous approval process for a SIB is not sufficient. Interestingly they have provided no suggestions on how to correct any perceived deficiencies.

## VI. CONCLUSION.

For the foregoing reasons, Staff urges the adoption of its positions herein and those of its Opening Brief.

RESPECTFULLY SUBMITTED this 25<sup>th</sup> day of April, 2014.

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Original and thirteen (13) copies of the foregoing filed this 25<sup>th</sup> day of April, 2014, with:

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<sup>65</sup> RUCO Closing Brief at 25 and 38.

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